

KLD Emerging Markets Research Methodology

I. Overview

KLD Research & Analytics, Inc. researches emerging market companies on behalf of the California Public Employees' Retirement System (CalPERS). Research is focused on the evaluation of corporate environmental, social and governance (ESG) performance relative to the CalPERS Emerging Equity Market Principles.

KLD rates company ESG performance based on an assessment of CSR practices and involvement in controversies concerning employee health & safety, labor relations, bribery and corruption, discrimination, community relations, human rights, and environmental impact. Based on its research findings, KLD provides a rating recommendation for each company of Pass, Watch List, and Red Flag, in addition to supplementary scoring information specific to Emerging Equity Market Principles 3 and 4.

II. Research Process and Sources

A. ESG Screening Criteria

KLD researches companies in the CalPERS-provided emerging markets universe (approximately 900 companies). The ESG screening criteria are based on the Emerging Equity Market Principles that, at the company level, are focused on the human rights, labor relations, and CSR standards embodied in the ILO Core Conventions (Principle 3) and the Global Sullivan Principles (Principle 4). While research centers on Principles 3 and 4, KLD also reports on company involvement in major controversies concerning any of the Principles, including those relating to civil liberties and freedom of the press. The Global Sullivan Principles and ILO Conventions are outlined in Table 1.

Table 1

<p>Global Sullivan Principles</p> <ul style="list-style-type: none"> (a) Support for universal human rights, and particularly, those of employees, communities and business relationships; (b) Equal opportunity for employees; (c) Voluntary freedom of association; (d) Living wage; (e) Providing a safe and healthy workplace, protecting human health and the environment, and promoting sustainable development; (f) Fair competition and abolition of bribery; (g) Working with governments and communities to improve quality of life in places of business; (h) Promotion of these principles; and (i) Transparency.
<p>ILO Core Labor Conventions</p> <ul style="list-style-type: none"> (a) Freedom of association and the right to collective bargaining; (b) Elimination of all forms of forced or compulsory labor; (c) Abolition of child labor; and (d) Elimination of discrimination in employment.

B. Sources

KLD performs an annual audit of CalPERS' emerging market equity universe in order to identify companies that violate the screening criteria, drawing on the following sources:

- Media reports - KLD uses the Dow Jones Factiva news service, which draws on approximately 14,000 global sources
- Company websites
- Company public filings and Sustainability reporting
- Regulatory Agencies
- Country Labor Assessment reports, compiled by Verité
- Non-governmental organizations such as:
 - Clean Clothes Campaign
 - Rainforest Action Network
 - AFL-CIO
 - Amnesty International
 - Burma Campaign UK
 - Human Rights Watch
 - Labour Behind the Label
 - Local NGOs, where available

III. Screening Methodology

KLD utilizes the aforementioned research process and sources to evaluate companies for adherence to the labor relations, human rights and CSR standards embodied by the Global Sullivan Principles and ILO Core Conventions. KLD assists CalPERS in determining which companies are appropriate for investment by designating each company with a rating of Pass, Watch list, or Red Flag. The final investment decision is at the discretion of CalPERS.

A "Red Flag" rating is reserved for companies that are the most egregious violators of screening standards. KLD determines whether a standard has been violated using the following criteria. Generally, Red Flag companies are those that:

- Recently faced allegations of using, or were otherwise involved with controversies regarding forced or child labor (*ILO* (b and c)).
- Are, or have been, involved in serious controversies with indigenous peoples, particularly in cases where the company has not respected the sovereignty, culture, human rights, and intellectual property of these peoples (*Global Sullivan* (a and g)).
- Are, or have been, the subject of major recent controversies related to employee relations and labor standards (*Global Sullivan* (a, d, and e)).
- Exhibit a pattern of major health and safety violations, particularly if they involve employee fatalities (*Global Sullivan* (e)).
- Have faced major recent allegations of sex or race discrimination as well as discrimination lawsuits, particularly when there appears to be a pattern of discrimination (*Global Sullivan* (b) and *ILO* (d))

- Exhibit a pattern of notably poor relations with labor unions or have suppressed their employees' right to collective bargaining (*Global Sullivan* (c) and *ILO* (a)).
- Are, or have been, involved in major controversies concerning their negative impact on a community. These controversies adversely affect the quality of life in the community and can include issues related to environmental contamination (*Global Sullivan* (e and g)).
- Exhibit a pattern of environmental regulatory problems, particularly ones that have resulted in substantial fines and penalties (*Global Sullivan* (e)).
- Exhibit a pattern of corrupt business practices, including bribery and fraud (*Global Sullivan* (f)).
- Are, or have been, involved in major human rights controversies not covered by any of the above criteria, such as the manufacture of landmines or significant operations in Burma or Sudan.

Principle 8, concerning ESG disclosure, and transparency with regard to the Global Sullivan Principles are also incorporated in KLD's analysis of company performance. For example, when controversies or breaches of global conventions are reported, KLD considers company disclosure regarding management policies or systems that are in place to address the issue(s) and/or company responses to the issue to prevent reoccurrence. KLD takes this information into account as a mitigating performance factor prior to make a ratings recommendation for the company.

A. Watch List

It is at times very difficult to judge whether or not a company's involvement in a certain controversy or issue constitutes a failure to adhere to the screening standards. In these cases, KLD assigns a Watch List designation to companies that, while raising serious concerns, may not clearly violate any of the above criteria. These companies are monitored closely for deteriorating or improving performance. This status alerts CalPERS to a company's problems and serves as a basis for further consultation on its performance.

B. Reporting

KLD provides CalPERS with an annual report on its emerging markets equity universe. In addition to an overall company rating of Pass, Watch List or Red Flag; KLD assigns each company a score for Principles 3 and 4, as outlined in Table 2. The report also includes details as to each company's involvement in major ESG controversies and incidents.

Table 2

CalPERS Policy	High Rating	Medium Rating	Low Rating
Principle 3	3 - High level of ILO compliance and/or no labor rights violations/issues (including child labor issues)	2 - Partial level of ILO compliance and/or isolated labor rights violations/issues (including child labor issues)	1 - Low level of ILO compliance and/or multiple labor rights violations/issues (including child labor issues)
Principle 4	3 - Full compliance with GSP and/or no major negative CSR incidents or issues.	2 - Partial compliance with GSP and/or isolated negative CSR incidents and issues	1 - Non-compliance with GSP and/or a pattern of negative CSR incidents and issues